IN THE HIGH COURT OF JUDICATURE
ANDHRA PRADESH
AT HYDERABAD

THE HON'BLE MR JUSTICE J.CHELAMESWAR
and
THE HON'BLE MR JUSTICE D.APPA RAO

WRIT PETITION NO :12124 of 2006

Dated: 12th October 2006.

Between:

Larsen & Toubro Limited, ECC Construction Division, II Floor, Navbharat Chambers, Raj Bhavan Road, Somajiguda, Hyderabad and another

..... PETITIONERS

AND

State of Andhra Pradesh rep by its Principal Secretary-Revenue Finance, Secretariat Buildings, Government of Andhra Pradesh, Hyderabad an others.

.....RESPONDENTS

THE HON'BLE SRI JUSTICE J.CHELAMESWAR

AND

THE HON'BLE SRI JUSTICE D.APPA RAO

W.P.NO.12124 OF 2006

ORAL ORDER:

(Per the Hon'ble Sri Justice J.Chelameswar)

The 1st petitioner is a Limited Company and the 2nd petitioner is a shareholder thereof. The prayer in the writ petition is as follows:

> " For the reasons and in the circumstances stated in the Accompanying Affidavit, the petitioners herein pray that this Hon'ble Court in the interests of Justice be pleased to issue a Writ a Mandamus or any other appropriate Writ, direction or order under Article 226 of the Constitution of India, 1950 declaring that Section 4(7), Explanation –VI to Section 2(28) of the Andhra Pradesh Value Added Tax Act, 2005, Rules 17(1) (a) and 17(1) (c) read with Rule 17(1) (e) made thereunder are repugnant to Article 366 (29A) (b) of the Constitution of India and the Scheme of Levy and recovery of taxes both at the hands of the nominated sub-contractors, who are registered dealers, remitting taxes as well as the main contractor like the

Petitioners, and is beyond the legislative competence of the State Legislature. Under Serial No.54 of List-II of the Seventh Schedule to the Constitution of India and the resultant assessment and recovery is violative of Articles, 14, 19(1)(g) and 265 of the Constitution of India,and consequently to set aside the order of the Third Respondent in FORM VAT 305 DATED: 31.05.2006, or pass such further or other orders as may deem fit and proper in the circumstances of the case."

The 2nd petitioner, obviously, joined the 1st petitioner as the 1st petitioner cannot claim a fundamental right under Article 19(1)(g) of the Constitution of India, in view of the decision of the Supreme Court in **COOPER R.C. v. UNION OF INDIA** [1]. The 1st petitioner company, inter alia, engaged in the execution of civil, mechanical and other contracts through out the territory of India. The 1st petitioner is a dealer registered under the A.P.V.A.T.Act and the C.S.T. Act, 1956 on the rolls of the 3rd respondent herein. The 1st petitioner entered into a number of contracts with various persons (herein after referred for the sake of convenience as "the employers"). All the employers, for the purpose of the present writ petition, happen to be Limited Companies either

Private or Public, the details of these various contracts may not be necessary for the purpose of this writ petition, except that admittedly, all these contracts are works contracts within the meaning of the expression occurring under Article 366(29A)(b) of the Constitution of India. During the period commencing from April 2005 to November 2005, the 1st petitioner, either wholly or partially, executed those various contracts numbering 108 and received certain payments from the employers, which constitute the turnover of the 1st petitioner for the said period.

The 3rd respondent by his proceedings dated 10-03-2006 proposed to assess the 1st petitioner's liability for tax under the A.P.V.A.T. Act, for the period commencing from April 2005 to January 2006, at Rs.13,30,99,589/-. The 1st petitioner replied to the same by its letter dated 13-04-2006. The 3rd respondent by his proceedings dated 31-05-2006, ultimately, assessed the liability of the 1st petitioner under the APVAT Act for the above mentioned period at Rs.9,75,89,261/- and demanded payment of the same.

The substance of the petitioner's case is that the execution of the various contracts referred to above, was entrusted to various "sub contractors" either wholly or partially. Wherever such execution was entrusted to a sub contractor, the State can either collect the tax under the

A.P.V.A.T. Act, from the sub contractor or from the petitioner and in the event of the State deciding to collect the tax from the petitioner, the amount of tax, if any, collected from the concerned

sub-contractor, must be given credit to while determining the tax liability of the petitioner. This contention of the petitioner is on the legal premise that notwithstanding the fact that the works contract was executed by the petitioner through a sub-contractor, there can only be one taxable event for the purpose of the A.P.V.A.T. Act, if the V.A.T. Act were to be consistent with the scheme of the Constitution, having regard to the language of Entry-54 of the II List of the Seventh Schedule r/w Article 366(29A)(b) of the Constitution, and therefore, tax can be collected only once for such taxable event. The objection of the petitioner was not accepted, resulting in the impugned assessment and demand. Hence, the writ petition.

Admittedly, the A.P.V.A.T. Act, 2005, is made by the Legislature of Andhra Pradesh in exercise of the authority vested in it by virtue of Entry-54 of the II List of the Seventh Schedule to the Constitution, which authorizes the State to levy tax on the sale or purchase of goods[2]. The scope and amplitude of this Entry has been the subject matter of incessant litigation for the last half a century in this Country.

Whether the goods utilized by a contractor in the

execution of a building contract (one of the categories of the works contracts) could legitimately be made exigible to the sales tax in exercise of the legislative competency under Entry-48 of the II List of the Seventy Schedule to the Government of India Act, 1935, (which corresponds to the present Entry-54 of the II List of the Seventh Schedule of the Constitution of India), fell for the consideration of the Supreme Court as early as in the year 1958 and a Constitution Bench of the Supreme Court in **STATE OF MADRAS v. GANNON DUNKERLEY & COMPANY**[3]. The Supreme Court held that the expression 'sale of goods' occurring under Entry-48 of the II List of the Seventh Schedule to the Government of India Act, 1935, did not authorize the levy of sales tax by the State Legislatures on the value of the goods utilized in the execution of a building contract. At Page No.386 of the said judgment, the Supreme Court held as follows:

> " To sum up, the expression "sale of goods" in Entry 48 is a *Nomen juris*, ***its essential ingredients being an agreement to sell movables for a price and property passing therein pursuant to that agreement.*** In a building contract which is, as in the present case, one, entire and indivisible-and that is its norm, there is no sale of goods, and it is not within the competence of the Provincial Legislature under

> Entry 48 to impose a tax on the supply of the materials used in such a contract treating it as a sale.
>
> This conclusion entails that none of the Legislatures constituted under the Government of India Act, 1935 was competent in the exercise of the power conferred by section 100 to make laws with respect to the matters enumerated in the Lists, to impose a tax on construction contracts and that before such a law could be enacted it would have been necessary to have had recourse to the residual powers of the Governor General under section 104 of the Act….." ***(emphasis supplied)***

The interpretation placed by the Supreme Court on the Entry 48 of the Seventh Schedule to the Government of India Act, 1935 continued to govern the interpretation of the Entry 54 of the List II of Seventh Schedule to the Constitution of India. In a long line of decisions of the Supreme Court, the statement of law remained unaltered for a long time. In the result, goods utilized in the execution of a works contract remained beyond the legislative competence of the States for the purpose of levy of tax in exercise of the power under Entry 52 of the List II of the Seventh Schedule to the Constitution. The States in their eternal search for additional sources of revenue did not give up their attempt. Eventually, the

Parliament was persuaded to amend the Constitution to enable the States to legitimately tax the transfer of goods involved in the execution of works contract. By 46th amendment of the Constitution, the expression ***"tax on the sale or purchase of goods"*** which was an undefined expression prior to the 46th amendment became a defined expression.

Right from the case of **Gannon Dunkerley's case (supra)**, the States took a stand in law that in a works contract like the construction contract, the property in the materials used therein passes to the employer and the contract could be split up into its component parts. This stand of the State was rejected by the Supreme Court in **State of Madras v. Gannon Dunkerley & Co (supra)** at page 385, the Supreme Court held that in the absence of any specific agreement between the parties to the contrary in a contract to construct a building, the materials used in execution of such contract would become the property of the other party (employer) to the contract only on the theory of accretion.

> "Another difficulty in the way of accepting the contention of the appellant as to splitting up a building contract is that the property in materials used therein does not pass to the other party to the contract as movable property. It would so

> pass if that was the agreement between the parties. But if there was no such agreement and the contract was only to construct a building, then the materials used therein would become the property of the other party to the contract only on the theory of accretion..”

In other words, there is no separate sale of goods in the materials used in the execution of the works contract and hence inexigible to the taxation in exercise of the power under Entry 54 of List II of Seventh Schedule of the Constitution of India. The Supreme Court in coming to such a conclusion primarily based its reasoning on the definition of the expression `sale of goods’ occurring in the Sale of Goods Act

> “If the words “sale of goods” have to be interpreted in their legal sense, ***that sense can only be what it has in the law relating to sale of goods.*** The ratio of the rule of interpretation that words of legal import occurring in a statute should be construed in their legal sense is that those words have, in law, acquired a definite and precise sense, and that, accordingly, the

> Legislature must be taken to have intended that they should be understood in that sense."
>
> ***(emphasis supplied)***

and drew support from a large number of English and Australian decisions rendered in that connection.

The Parliament in its capacity as a Constituent Assembly therefore resorted to the constitutional definition of the expression ***"sale or purchase of goods"*** under sub-Article 29A of the Article 366. The Transfer of Goods utilized by a contractor in the execution of the works contract is deemed to be a sale of goods in favour of the employer under the legal fiction created under Article 366 sub-Article 29A. Though in **Gannon Dunkerley & Co's case,** Supreme Court laid down at page 365 of the judgment **(supra)** that the property in the goods utilized in the execution of a works contract does pass on to the employer not by virtue of any voluntary act of transfer of property recognized by the Sale of Goods Act, but by virtue of the doctrine of accretion. In this context at page 365, the Supreme Court observed ***"Thus, if merely title to the goods passes but not as a result of any contract between the parties, express or implied, there is no sale."*** In our view, in order to get over this specific observation precisely clause (b) was incorporated in sub-Article (29A) of Article 366.

The principle laid down in **Gannon Dunkerley's case** that in the absence of a specific contract to the contrary, the property in goods utilized in execution of a works contract pass to the employer by accretion still holds the field notwithstanding the amendment of the Constitution by way of sub-Article (29A) of Article 366.

The principle was reiterated after taking note of the 46th Amendment of the Constitution by the Supreme Court by another Constitution Bench of the Supreme Court in **Builders Association of India v. Union of India**[4]**.** The Supreme Court observed at page 400 as follows :

> "….After the 46th Amendment the works contract which was an indivisible one is by a legal fiction altered into a contract which is divisible into one for sale of goods and the other for supply of labour and services. After the 46th Amendment, it has become possible for the States to levy sales tax on the value of goods involved in a works contract in the same way in which the sales tax was leviable on the price of the goods and materials supplied in a building contract which had been entered into in two distinct and separate parts as stated above. It could not have been the contention of the Revenue prior to the 46th Amendment that when the goods and materials had been supplied under a

distinct and separate contract by the contractor for the purpose of construction of a building the assessment of sales tax could be made ignoring the restrictions and conditions incorporated in article 286 of the Constitution. If that was the position can the States contend after the 46th Amendment under which by a legal fiction the transfer of property in goods involved in a works contract was made liable to payment of sales tax that they are not governed by article 286 while levying sales tax on sale of goods involved in a works contract? They cannot do so. When the law creates a legal fiction such fiction should be carried to its logical end. There should not be any hesitation in giving full effect to it. If the power to tax a sale in an ordinary sense is subject to certain conditions and restrictions imposed by the Constitution, the power to tax a transaction which is deemed to be a sale under article 366(29-A) of the Constitution should also be subject to the same restrictions and conditions. Ordinarily unless there is a contract to the contrary in the case of a works contract the property in the goods used in the construction of a building passes to the ***owner of the land on which the building is constructed, when the goods or materials used are incorporated in the building.”***

(emphasis supplied)

It’s a different matter that even such a passing of

the title by virtue of the legal fiction created under 46th amendment to the Constitution, becomes a taxable event constituting Sale of Goods within the meaning of the said expression occurring under Entry 54 of the List II of the Seventh Schedule.

It is in this background of the constitutional principles the issues involved in the present writ petition are required to examined.

Before we examine the impugned provisions of the APVAT Act, 2005, a brief survey of the scheme of the relevant provisions of the Act in our view is necessary. Under Section 80 of the said Act, the A.P. General Sales Tax Act, 1957 is repealed. A new regime of taxation on the sale and purchase of goods is put in place. Section 4 of the APVAT Act is the charging Section. Sub-section (7) of Section 4 creates a levy of tax on dealers executing ***"works contracts"*** - a defined expression under Section 2(45) who form a class and popularly called contractors. Under sub-section (a) every such dealer shall pay tax on the value of the goods utilized by him in the execution of works contract. The rate of tax is specified to be the rate of tax applicable to those goods if sold otherwise than by way of utilization in execution of the works contract. Under the proviso, if the dealer/contractor does not maintain the accounts to enable the State to determine the correct value of the goods at the time of incorporation, such dealers

are required to pay tax at the rate of 12.5% on the total consideration of the contract. Section 7(b), (c) and (d) deal basically with dealers who exercise an option to pay tax by way of composition. [The procedure for composition is stipulated under Rule 17(2), (3) and (4) of the Rules made under the Act.] While the above mentioned three sub-clauses of Section 4(7) deal with those contractors who opt for the payment of tax by way of composition, sub-clause (b) deals with those contracts entered into between such a dealer on one hand and the government; or a local authority on the other hand. Sub-clause (c) deals with contracts entered into between such a dealer and persons other than a Government or local authority. Sub-clause (d) specifically deals with the contracts of construction and selling of residential apartments, houses etc. Each one of these sub-clauses stipulate a specific rate of tax computed at a percentage of the total value of the contract or a part thereof.

It is asserted by the learned senior counsel Sri Natarajan that the 1st petitioner has not exercised his option to pay the tax if any by way of composition and therefore it's liability to pay tax is to be decided in accordance with clause (a) of sub-Section 7, whereas in the counter at Paragraph No.21 it is stated as follows:

> " …. Moreover, the petitioner is under composition payment of tax under section 4(7)(c) of the APVAT Act, read with 17(3)(g)

of the APVAT Rules……."

As already noticed, a substantial portion of the work under the various contracts entered into by the 1st petitioner and referred to earlier had been executed by the various sub-contractors, some of them are made parties as respondents to the present writ petition. It is asserted by the petitioner that each one of those sub-contractors whether they are parties to the petition or not has in fact paid tax under the provisions of the APVAT Act with respect to the work executed by them. It is further asserted by the petitioners that in some cases sub-contractors have opted for the payment of tax by way of composition and in other cases in accordance with the provision under sub-section 7(a) of Section 4. These factual uncertainties need not matter, for deciding the issue before us.

It is the case of the petitioners that the amount of tax paid by the sub-contractors must be given credit to while computing the tax liability of the 1st petitioner on the turnover relating to a particular contract or a set of contracts executed during a specified period relevant for the assessment under the VAT Act.

It must be mentioned here that neither the Act nor the rules made there under make a specific provision for giving of credit such as the one claimed by the petitioner except a credit on the inputs contemplated under Section 13 of the Act. Section 13(1) of the Act authorizes such a credit to a

VAT dealer who purchases taxable goods under certain circumstances, the details of which are not relevant for the present purpose. However, sub-section (5) is relevant in the present context which insofar as it is necessary for our purpose reads as follows:

> **"13(5).** No input tax credit shall be allowed on the following:
>
> (a) works contracts where the VAT dealer pays tax under the provisions of clauses (b), (c) and (d) of sub-section (7) of Section 4;"

In substance, sub-section (5) denies the benefit of the input tax credit provided under sub-section (1) to the dealers who are taxable under sub-section (7) of Section 4 if they happen to opt for payment of tax by way of composition.

The questions raised in this writ petition are that:

(1) Section 4(7),
(2) Section 2(28); Explanation VI; and
(3) Rule 17(1)(a), (c) and (e) of the Rules made under the VAT Act;

are unconstitutional for the reasons:

(i) that they are repugnant to Article 366 (29A) (b) and consequently beyond the legislative competency of the State in exercise of the power under Entry-54 of the II List of the Seventh Schedule; and

(ii) violative of Articles 14, 19(1)(g) and 265 of the Constitution of India.

A counter-affidavit is filed by the 3rd respondent. The respondents have identified the issues correctly. Paragraph No.4 of the counter is as follows:

> " It is submitted that the petitioner precisely raised the following issues in the writ petition for adjudication by this Hon'ble Court.
>
> (a) Under Article 366, clause 29(A)(b), there is only one transfer, which attracts tax on the deemed sales of goods involved in the execution of works contract. It does not authorize levy of tax on multi point.
>
> (b) Turnover relating to work awarded to sub-contractor is not given deduction while determining the turnover of the petitioner, being the main contractor.
>
> (c) Once the petitioner as main contractor assigns the work to the sub-contractor, the work is carried out by the sub-contractor involving transfer of property from him and the transfer on the principles of accession, peculiar to construction contract. The role of the petitioner, being main contractor is only for payment for work.

(d) There is no transfer of property in the material employed by the sub-contractor to the petitioner, nor the petitioner effects transfer of goods to contractee or transferee, as required under Article 366 29(A)(b). As, such petitioner is not chargeable to tax."

The crucial issue is whether in a transaction of entrustment of a works contract by the contractor to the sub-contractor, there is one taxable event under the VAT Act or two, is answered by the respondents at Paragraph No.16 of the counter-affidavit as follows:

" ..... It being so, there are ***two deemed sales*** one from main contractor to contractee and the other from sub-contractor to the main contractor in the event of contractee not having privity of contract with the sub-contractor. In the present case, there is no contractual obligation between the Employer – contractee and the sub-constractor....."

In substance, there are two deemed sales and, obviously, therefore, two taxable events for the purpose of VAT Act. At Paragraph No.17, it is further stated as follows:

" 17. The APVAT Act identifies main contractor and sub-contractor as independent from each other in so far as

deemed sale under clause 29-A(b) of Article 366 is concerned."

On the other hand, the counter makes elaborate references to Rule 17 in an attempt to justify the impugned assessment order. Therefore, it becomes necessary to examine Section 4(7) and Rule-17.

Section 4(7) of the Act reads as follows:

" (7) Notwithstanding anything contained in the Act:-

(a) Every dealer executing works contract shall pay tax on the value of goods at the time of incorporation of such goods in the works executed at the rates applicable to the goods under the Act:
Provided that where accounts are not maintained to determine the correct value of goods at the time of incorporation, such dealer shall pay tax at the rate of 12.5% on the total consideration received or receivable subject to such deductions as may be prescribed;

(b) Any dealer executing any works contracts for the Government or local authority may opt to pay tax by way of composition at the rate of 4% on the total value of the contract executed for the Government or local authority and in such cases, the tax at 4% shall be collected at source by such contractee and remitted to

Government in such manner as may be prescribed:

(c) Any dealer executing works contracts other than for Government and local authority may opt to pay tax by way of composition at the rate of 4% of fifty per cent (50%) of the total consideration received or receivable for any specific contract subject to such conditions as may be prescribed;

(d) Any dealer engaged in construction and selling of residential apartments, houses, buildings or commercial complexes may opt to pay tax by way of composition at the rate of 4% of twenty five percent (25%) of the consideration received or receivable or the market value fixed for the purpose of stamp duty whichever is higher subject to such conditions as may be prescribed;

(e) Any dealer having opted for composition under clauses (b), (c) and (d), purchases or receives any goods from outside the State or India or from any dealer other than a Value Added Tax dealer in the State and uses such goods in the execution of the works contracts, such dealer shall pay tax on such goods at the rates applicable to them under the Act and the value of such goods shall be excluded for the purpose of computation of turnover on which tax by way of composition at the rate of

four per cent (4%) is payable;

(f) Any dealer who is liable to be registered for TOT and executing any works contracts shall pay tax at the rate of 1% on total value of the goods at the time of incorporation of the goods used:
Provided that where accounts are not maintained to determine the correct value of the goods at the time of incorporation, such dealers shall pay tax at the rate of 1% on the total consideration received or receivable subject to such deductions as may be prescribed……”

The contours of Section 4(7) of the Act, have already been noticed earlier in this judgment.

Rule-17 deals with the procedure to be followed while making assessment of the liability of a dealer carrying on the business of execution of a works contract. Rule-17 comprises of five sub-rules. Each one of these deals with the works contracts contemplated under various clauses of Section 4 (7) of the Act. Rule-17(2) deals with works contracts covered under Section 4 (7) (b); Rule-17(3) with works contracts covered under Section 4 (7) (c); Rule-17(4) with works contracts covered under Section 4 (7) (d); Rule-17(5) with works contracts falling under Section 4(7)(e); and Rule-17(1) with works contracts falling under Section 4(7)(a).

It may not be necessary for us to examine the scheme of entire Rule-17 for the purpose of the present case,

except to state that sub-rules 1 to 4 in sub-clauses (c), (j), (g) and (g) thereunder, respectively, recognise the possibility of a contractor executing a works contract, through to a sub-contractor. They read as follows:

> " 17(1) (c): If such VAT dealer awards any part of the contract to a sub-contractor, such sub-contractor shall issue a tax invoice to the contractor for the value of the goods at the time of incorporation in such sub-contract. The tax charged in the tax invoice issued by the sub-contractor shall be accounted by him in his returns.
>
> 17(2) (j): In the case of a contractor mentioned in clause (a), if any part of the contract is awarded to a sub-contractor, the sub-contractor shall be exempt from tax on the value of the sub-contract. The sub-contractor shall not be eligible to claim input tax credit on the inputs used in the execution of such sub-contract;
>
> 17(3) (g): Where the contractor VAT dealer awards any portion of his contract to a sub-contractor, such contractor shall not be eligible for any deduction relating to the value of the sub-contract. The sub-contractor if he is a VAT dealer, in such a case may either opt for

composition under clause (c) of sub-section (7) of Section 4, or pay tax under clause (a) of sub-section (7) of Section 4.

17(4)(g): Where the contractor VAT dealer specified in clause (f) above, awards any portion of his contract to a sub-contractor, such contractor shall not be eligible for any deduction relating to the value of the sub-contract. The sub-contractor if he is a VAT dealer, in such a case may either opt for composition under clause (d) of sub-section (7) of Section 4, or pay tax under clause (a) of sub-section (7) of Section 4."

While sub-rule(1)(c) requires the sub-contractor to issue a tax invoice to the contractor for the value of the goods at the time of incorporation, the rule is silent whether any tax paid under the Act by the sub-contractor for the said goods shall be given credit to or not. On the other hand, sub-rule 2(j) specifically exempts the sub-contractor from the tax liability under the Act, thereby making only the main contractor liable and consequently one taxable event in the whole transaction, Under sub-rule (3)(g) a vague declaration is made that "the contractor shall not be eligible for any deduction relating to the value of the sub-contract", whereas under sub-rule(4)(g) a declaration similar to the one made under sub-rule(3) is

enacted.

An examination of these various sub-rules, in our view, does not throw any light as regards the number of taxable events involved in the cases of works contractors awarding either wholly or partially a part of the works contract in favour of a sub-contractor. At any rate, the rules even if they are to be construed as creating two taxable events, at best they indicate only the understanding of the State of the legislative mandate contained in the VAT Act. But such an understanding is not conclusive of the true import of the enactment, much less the constitutionality of the enactment.

For the purpose of the present case, we proceed on the footing - (without deciding so) that the language of the charging section facially recognizes the existence of two taxable events in such case, then the question would be, whether such recognition is consistent with the scheme of Article 366(29A) (b) of the Constitution of India.

Before we examine the question whether the expression `tax on sale or purchase of goods' occurring under Entry 54 of List II enables the legislature of a State to create two taxable events in the transaction of the execution of a works contract by a contractor by ***"awarding"*** either wholly or partially the contract in favour a sub-contractor, we must necessarily examine the legal rights and obligations of the three parties involved in the transaction viz., (1) the employer or the contractee, (2) contractor and (3) the sub-contractor.

The expression **`*works contract'*** is a defined expression under Section 2(45). It reads as follows :

> ***"Works Contract"*** includes any agreement for carrying outt for cash or for deferred payment or for any other valuable consideration, the building construction, manufacture, processing, fabrication, erection, installation, laying, fitting out, improvement, modification, repair or commissioning of any movable or immovable property;"

It can be seen from the definition that essentially a works contract is an agreement between two parties for carrying out any one or some of the various activities enumerated in the definition, like construction of a building etc., for a valuable consideration. By definition, it pre-supposes the existence of an agreement. The expression `agreement' though not defined under the VAT Act, in the realm of the Law of Contract is understood as defined under the Indian Contracts Act, 1872 as a set of promises forming the consideration for each other. Therefore, in a works contract, the contractor promises to carry out some obligations like the construction of a building, fabrication of machinery etc., in consideration of the employer promising to pay a certain amount either in cash or in the form of some other valuable consideration.

Similarly, when the contractor awards either wholly or partially, the contractual obligation to a sub-contractor there is another agreement between the contractor and the sub-contractor which is *pro tanto* identical in nature with the agreement between the employer and the contractor. Therefore, there are two works contracts in existence between the three parties mentioned above ***for the carrying out of one and the same task.***

It must be noticed that there is no agreement between the employer and the sub-contractor and consequently there is no legal relationship creating either rights or obligations between them under an agreement. In between the employer and the sub-contractor, in our view, the relationship is simply that the sub-contractor is an agent of the contractor. Under Section 182 of the Indian Contracts Act, an `agent' is defined to be a person employed to do any act for another. Looked at from this angle, the role of a sub-contractor in the context of the issue under examination is simply that of an agent of the contractor either from the point of view of the employer or from the point of view of the rest of the world. Though there are two agreements satisfying the definition of a works contract under the VAT Act, in the context of the issue in the present writ petition, whether those two agreements create two separate taxable events for the purpose of the VAT Act is a matter to be examined.

The authority of the State to levy and collect tax on

the material used by the contractor in the execution of a works contract flows from the Article 246(3) read with Entry 54 of List II of the Second Schedule. The said Entry authorizes the State to levy and collect taxes on the sale or purchase of goods other than newspapers that take place within the State. Therefore, the authority of the State extends to levy and collect the tax wherever there is either a sale or purchase of goods. In other words, the taxable event for the purpose of the above mentioned Entry is either the sale or purchase of goods. The expressions `sale' or correspondingly `purchase' as we have already noticed from **Gannon Dunkerley's case (supra)** was required to be understood in a definite legal sense as known to India on the date of the commencement of the Constitution. The Supreme Court in **Gannon Dunkerley's case (supra)** held "***... in order to constitute a sale it is necessary that there should be an agreement between the parties for the purpose of transferring title to goods, which of course presupposes capacity to contract, that it must be supported by money consideration, and that as a result of the transaction property must actually pass in the goods. Unless all these elements are present, there can be no sale. Thus, if merely title to the goods passes but not as a result of any contract between the parties, express or implied, there is no sale....".*** The Supreme Court came to the conclusion in the said case that in a transaction of a works contract like a construction contract in

the absence of a specific agreement to the contrary, unless the property in goods used in the execution of a contract passes to the employer, there is no sale of goods and consequently there is no taxable event falling within the ambit of Entry 54 of List II of the Seventh Schedule of the Constitution. Parliament defined the expression ***"tax on sale or purchase of goods"*** by introducing sub-Article 29A of Article 366 and created a legal fiction that the transfer of property in goods involved in the execution of works contract shall be deemed to be sale of those goods by the person making the transfer of property in such goods.

By this amendment, Clause 29A was inserted in Article 366 of the Constitution which reads as follows :

> `[(29A) "tax on the sale or purchase of goods" includes-
>
> (a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;
>
> (b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;
>
> (c) a tax on the delivery of goods on hire-purchase or any system of payment by instalments;
>
> (d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other

valuable consideration;

(e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;

(f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service is for cash, deferred payment or other valuable consideration,

and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made;'.]

Article 366 defines various expressions occurring in the Constitution. From the definition under sub-Article (29-A), the following factors are to be noticed. First of all the definition is an inclusive definition. Clause (a) and (b) of sub-Article 29A deal with the tax on the transfer of property in goods while clause (c) deals with only tax on the delivery of goods either on hire purchase or any other system of payment by instalments. Clause (d) deals with tax on the transfer of only the right to use the goods while clauses (e) and (f) deal with the tax in the event of supply of goods under the various

conditions contemplated by the said clauses.

In all the above mentioned contingencies, by a constitutional definition either the transfer, delivery or supply as the case may be is deemed to be a sale of goods by the person making either the transfer or delivery or supply and correspondingly a purchase in the hands of the person receiving the goods. Without going into the details of the historical background which necessitated the incorporation of the various clauses, it is sufficient to mention that each of those clauses was intended to get over some decision of the Supreme Court or the other which declared those various transactions (now sought to be covered under these various clauses) to be not involving the transaction of sale of goods for the purpose of Entry 54 of the List II of the Seventh Schedule.

For the purpose of the present case, the relevant clause under sub-Article (29A) is clause (b). The said clause obviously was intended to remove the basis of the decisions of the Supreme Court commencing with **Gannon Dunkerley.**

In view of the amendment, the transfer of property in goods utilized in execution of a works contract though did not amount to sale of such goods prior to the introduction of sub-Article 29A, it does amount to sale of goods in view of the legal fiction newly created and consequently is a taxable event within the ambit of Entry 54 of the List II.

In a transaction of a works contract, the property in

goods passes directly to the employer by the theory of accretion which is already taken note of in this judgment. It does not appear to us that at any point of time, the property in the goods passes to the contractor where the work is executed by a sub-contractor. The respondents could not bring to our notice any principle of law which establishes that the property in goods passes to the contractor at any stage of the execution of the works contract in the event of a contractor awarding the contract to a sub-contractor. The sub-contractor as we have already noticed is only an agent of the contractor and the property in goods passes directly from the sub-contractor to the employer and therefore there can only be one sale which is recognized by the legal fiction created under sub-Article 29A of Article 366. It therefore leads us to the conclusion that there is only one taxable event of sale of goods in such a transaction. The understanding of the State that there are two taxable events in such a transaction in our view has no legal basis.

To hold that there are two taxable events in such a transaction, enabling the State to levy and collect tax both from the sub-contractor and the contractor in our view would be violative of Article 14 also for the reason that wherever a contractor executes a works contract himself without employing the sub-contractor the deemed sale of goods involved in such execution of works contract would attract the tax only once and whenever the contractor employs a sub-

contractor, the transfer of property in the same goods involved in the execution of such works contract attracts the tax twice over, which in our view is plainly irrational and violative of Article 14 of the Constitution of India.

In view of the above conclusion, we do not propose to declare any of the impugned provisions unconstitutional but we declare that those provisions must be understood as explained in this judgment.

Coming to the question in what manner the State proposes to collect the tax, we declare that it is open for the State to frame appropriate rules to collect the same either from the sub-contractor or from the contractor, we emphasise, not from both.

Coming to the assessment made against the petitioner, we hold that in view of the legal position declared in this judgment, the assessment must be set aside as it proceeded on a plainly erroneous understanding of the law that there are two taxable events, one in the hands of the sub-contractor and one in the hands of the contractor (1st petitioner). It is, however, open for the respondents to pass a fresh assessment order of the liability of the 1st petitioner for the period in question in the light of this judgment after giving an appropriate opportunity to the petitioner.

J.Chelameswar, J

D.Appa Rao, J

Mrk/knk

12th October 2006

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[1] AIR 1970 SC 564

[2] **Entry 54 List II of VII Schedule –** Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I.

[3] [1958] 93 STC 353 : AIR 1958 SC 560

[4] [1989] 73 STC 370